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C O N F I D E N T I A L SECTION 01 OF 03 MUSCAT 000860

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STATE FOR NEA/ARP, EEB/IFD/OMA
COMMERCE FOR ITA/COBERG
TREASURY FOR VALVO

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SUBJECT: MINISTER CONFIDENT OF OMAN'S FISCAL POSITION

REF: A. MUSCAT 771

¶B. MUSCAT 652

Classified By: Ambassador Gary A. Grappo for Reasons 1.4 (b and d)

Summary

¶11. (C) Omani Minister of National Economy Ahmed Macki is upbeat on the Sultanate's financial health, despite the significant damage and expense of recovery from Tropical Cyclone Gonu in June. Of greater concern to the Minister is the general rise in prices, which is leading to a lack of affordable housing and a dearth of contractors to carry out government projects. Macki is equally concerned about the impact of lower than expected gas reserves on the country's industrialization plans, which has prompted him to explore other opportunities to augment gas supplies, including from Iran. On the dissolution of Gulf Air, the Minister was caught off-guard by Bahrain's intention to go it alone, but nevertheless is focused on building up Oman Air. End Summary.

Recovering from Gonu

¶12. (C) On September 4, the Ambassador discussed the state of government finances with Minister of National Economy (and supervisor of the Ministry of Finance) Ahmed bin Abdul Nabi Macki. Macki noted that the government was well-positioned financially, even after taking into account the devastating impact of Tropical Cyclone Gonu, which he estimated caused approximately 700-800 million rials (USD 1.8-2.1 billion) in damage. To finance recovery efforts, Macki stated that the government would draw from its "Emergency Fund," rather than its primary State General Reserve Fund. Therefore, recovery expenditures will have no impact on this year's fiscal budget. The government has already made small disbursements ranging from 1,000 to 2,000 rials (USD 2,600-5,200) to various individuals and families in immediate need, in addition to providing temporary housing for approximately 650 families who had lost their homes. According to the Minister, the government was now proceeding to compensate small business and individual Omanis and expatriates (including church organizations) for their property losses, which will amount to approximately 80 million rials (USD 207 million). Macki justified the generous government handout on the basis that it provides a more equal "distribution of wealth" in pursuit of "social harmony." Large companies which failed to take out insurance policies, however, would not benefit from this assistance program, added the Minister.

¶13. (C) Macki was more concerned about the impact of the Gulf region's building boom on Omani ministries' ability to carry out proposed projects than on the availability of capital. He noted that there was "lots of money" authorized under the Sultanate's five-year plan for 2006-2010, but doubted that the ministries would be able to spend it all due to contractor scarcity. "Usually, we only have two interested bidders," commented the Minister, "when we need three to comply with our tender laws." The government has responded by creating a special committee consisting of officials from the Ministry of Finance, Tender Board, and Audit Office to negotiate tenders that attract only one or two bidders. As for participation of U.S. contractors, Macki resigned himself to the fact that the Omani market was probably too small for such interest, and that American firms would likely be too expensive. The government, however, is still interested in encouraging foreign firms to participate in tenders, and has installed attractive incentive programs for them in efforts to break the local "monopoly."

Housing Crunch

¶14. (C) Macki commented that the lack of contractor interest in Oman was affecting overall housing inventory. He readily acknowledged that supply was not keeping up with demand, a fact exacerbated by the private sector's perception that building residential housing is currently cost-prohibitive. The Minister conceded that the Sultan is aware of this problem and has asked the cabinet to identify ways to increase the housing stock. The government has already moved both to raise the limit on building heights from ten floors

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to 12, and to encourage apartment construction as opposed to single-family homes. Macki also suggested that the government would consider measures to curb "exaggerated and unacceptable" rent hikes during its September 9 cabinet meeting.

¶15. (C) As for the Sultanate's overall price index, Macki stated that Oman was fortunate to have an inflation rate of only 5%, as compared to its regional neighbors -- especially Qatar and the Emirates -- where official rates were upwards of 10%. He acknowledged that broad price increases were affecting the economy, and pointed out that the rising cost of cement was particularly problematic. To counter the cement shortage, Macki stated that the government was importing cement at a subsidized rate and has ceased exports to Yemen.

Where's the Energy?

¶16. (C) Responding to the Ambassador's inquiry regarding the availability of natural gas, the Minister quipped, "We have a problem. There is no gas." Macki placed the blame squarely on the shoulders of Royal Dutch Shell, a 34% stakeholder in majority government-owned Petroleum Development Oman (PDO). "It's Shell's mistake," commented the Minister. "They were supposed to know what's under the ground." Macki highlighted the fact that in the late 1990s Shell estimated Oman's natural gas reserves to be 18.2 trillion cubic feet (TCF), and predicted that reserves would rise 1 trillion cubic feet each year to reach 30 TCF. Shell's figures, rued the Minister, turned out to be "overly optimistic," as Oman's reserves were eventually revised downward to 14 TCF. The revision placed Oman in an "awkward position," said Macki, as it is now bound to honor large, long-term contracts to European and Asian clients.

¶17. (C) The Minister criticized Shell for miscalculating

Oman's petroleum reserves as well. "It's the same thing with oil," remarked Macki. "Shell tells me in 2002 that it can produce 850,000 barrels per day (bpd), and so I create a budget based on these projections. Then six months later, Shell says they can't deliver 850,000 bpd, they can only deliver 800,000 bpd. Then they come back another six months later and tell me that production will be down to 730,000." As a result of Shell's miscalculations and inability or unwillingness to exploit its concession fully, Macki stated that the government began transferring parts of Shell's concession to other foreign operators, such as Los Angeles-based Occidental Petroleum, as well as BP and British Gas, among others. "PDO employs a tactic of delay when they can't produce," surmised the Minister. "So, we just took it from them." By contrast, Macki gave Occidental high marks. "(Occidental CEO) Irani was a good friend of mine when I was Ambassador to the United States. In sitting with Oxy, the situation is always very clear."

¶8. (C) The Minister noted that Shell tried to challenge the government's reallocation of the Mukhaizna concession to Occidental, but that the Dutch-Anglo company backed down when the government threatened to sue over its inflated production estimates. Macki mused that the government had to remind Shell of their "long-standing friendship" and the need to be more proactive in exploring their concession. The message worked, as PDO moved quickly to begin production of the Habhab fields, made available when the government reduced its Oryx Sanctuary from 32,000 square kilometers down to 2,000. Responding to criticism leveled by the media regarding the downsizing of the sanctuary, the Minister replied, "What's more important to our people, oil or the oryx?" He reasoned that the sanctuary was far too large for the small population of oryx (estimated at about 150) that resided there, and that its rightsizing would be easier for the government to manage in any event.

The Iranian Connection

¶9. (C) The Ambassador inquired about Oman's recent agreement with Iran on jointly exploring gas production fields in the Strait of Hormuz. Macki responded that given Oman's acute shortage of gas, all options were on the table. The Minister further commented that under the proposed arrangement with Iran, Oman would be responsible for all capital development costs, though prices had yet to be agreed upon. Reminded by

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the Ambassador of the implications of the Iran Sanctions Act on companies doing business with Iran, Macki countered that many European firms already were engaged in Iran. "If we are good friends with the United States, then we should be able to do this, as our need for gas is great," he added.

Gulf Air Divorce

10 (C) On the dissolution of Oman's partnership with Bahrain in Gulf Air, Macki, now the chairman of Oman Air, noted that he was "taken by surprise by the position of the Bahrainis." He stated that Oman had wanted to keep a 25% stake in the carrier to support Bahrain, but when Gulf Air presented him with three restructuring options, all seemed to indicate that Oman would not be taking any part in the airline's future. With the final separation now being determined by auditors, Macki said that the Sultanate was focused on building Oman Air's long-haul fleet. The Minister said that he "wanted to buy the Boeing 787," but that deliveries were not available until 2014. The airline consequently decided to pick up five Airbus 330-200 aircraft for delivery beginning in 2009. In the meantime, Oman Air will lease aircraft to begin London and Bangkok service in November 2008, followed by direct flights to Paris and Kuala Lumpur in 2009.

GRAPPO